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Proposed Revisions to Regulation Y

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PROPOSED REVISIONS TO REGULATION Y

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On September 6, 1996, the Federal Reserve Board published its proposed revisions to Regulation Y.[1] It is part of a comprehensive review of all regulations, designed to eliminate unnecessary regulatory burdens, to streamline the Regulation and regulatory processing, to conform the Regulation to Board practice and policy, and to modernize the provisions. The revision affects nearly all aspects of the Regulation.

The Board indicated that it had attempted to follow several principles in proposing changes in the Regulation. First, it stated that it wished to set forth objective and verifiable measures for each of the criteria in the Bank Holding Company Act. Those organizations that met the criteria could proceed rapidly in obtaining required approvals under the Act and Regulation. Second, it stated that the application/approval process should focus on the specific proposal, and not become the vehicle for a comprehensive evaluation of the organization. The application process should not become a substitute for general supervision and evaluation through the examination process. Third, in certain areas, the Board indicated that it wished to remove unnecessary restrictions on bank holding companies that were not otherwise applicable to banks engaging in the same services. Finally, it indicated that in many areas it wished to move as far as the law would allow in freeing bank holding companies from outmoded restrictions. These principles appear to have driven many of the proposed changes to the Regulation. The revisions may be summarized as follows:

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1. Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. 47,260 (1996) (to be codified at 12 C.F.R. pt. 225) (proposed Sept. 6, 1996); *see also* Preamble to Proposed Regulation on Bank Holding Companies and Changes in Bank Control (Regulation Y), 47,242 (1996).

I. BANK ACQUISITIONS

Well capitalized and well managed banks may acquire other banks under a 15 day notice provision. In order to take advantage of this provision, a bank holding company, its lead bank and banks representing 80% of consolidated assets must be well capitalized and have one of the two highest BOPEC or CAMEL ratings with at least satisfactory management, compliance and CRA ratings; the acquisition must provide a total market share of less than 35% and be within the Fed antitrust guidelines (HHI results within the 1800/200 point range); the acquisition and all acquisitions within the previous 12 months (both bank and non-bank) must represent less than 35% of consolidated assets measured at the beginning of the 12 month period; there must be no interstate issues (such as age requirements or deposit caps); and no supervisory problems must exist. [2]

The process would involve providing the Reserve Bank with 15 days written notice of the transaction, the parties, and pro forma financial and competitive information. Notice would be published, with a 30-day comment period.[3]

The pre-acceptance review period for banking acquisitions would be eliminated. Section 3 applications need not be pre-filed, and no staff pre-review will be required. This should shorten the application/approval process for most transactions.

Legal notices could be published up to 30 days prior to filing of applications. The Fed could be requested to publish the Federal Register notice early as well. This change is critical if the 15-day notice process is to have any meaning.[4]

Once again, the Federal Reserve states that it intends to adhere strictly to the comment periods. Late or supplemental comments would theoretically be rejected absent "compelling circumstances."

The waiver process for bank-to-bank mergers is to be clarified and streamlined. Where the transaction requires no approvals for

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2. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,264 (stating the proposed amendments to 12 C.F.R. § 225.11); *see also* Preamble to Proposed Regulation on Bank Holding Companies and Changes in Bank Control (Regulation Y), at 47,244-45 (summarizing the proposed revisions in subpart B).

3. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,266-67 (stating the proposed amendments to 12 C.F.R. § 225.14); *see also* Preamble to Proposed Regulation on Bank Holding Companies and Changes in Bank Control (Regulation Y), at 47,244-45 (summarizing the proposed revisions in subpart B).

4. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,267 (stating the proposed amendments to 12 C.F.R. § 225.16(b)); *see also* Preamble to Proposed Regulation on Bank Holding Companies and Changes in Bank Control (Regulation Y), at 47,244-45 (summarizing the proposed revisions in subpart B).

holding company subsidiaries, the bank-to-bank merger is simultaneous with the holding company merger and there are no capital problems, the bank holding company may send in a written request for a waiver, providing a description of the transaction and a copy of the Bank Merger Act application. If no Fed objection is received in 10 days, no further Bank Holding Company Act application will be required. There is a similar exemption for internal reorganizations involving well capitalized holding companies and their controlled banks.[5]

II. NON-BANKING ACTIVITIES

Similar to the provision addressing bank acquisitions, well capitalized and well managed banks may commence non-banking activities or acquire companies engaged in non-banking activities under a 15 day notice provision. The same criteria are used (well capitalized, one of the two highest BOPEC and CAMEL ratings, satisfactory management components, no supervisory problems, etc.). In addition, the acquisition and all acquisitions within the previous 12 months (both bank and non-bank) must represent less than 35% of consolidated assets measured at the beginning of the 12 month period. The activity must be on the approved list.[6]

The process would involve providing the Reserve Bank with 15 days written notice of the transaction, the parties, and pro forma financial and competitive information. Notice would be published, with a 30-day comment period.[7]

This particular aspect of the proposed revision was superseded in part by provisions of the regulatory relief provisions contained in recently enacted legislation. Similar to the proposed rule, well capitalized, well managed institutions may commence any activity

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5. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,264-65 (stating the proposed amendments to 12 C.F.R. § 225.12(d)); *see also* Preamble to Proposed Regulation on Bank Holding Companies and Changes in Bank Control (Regulation Y), at 47,244-45 (summarizing the proposed revisions in subpart B).

6. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,269 (stating the proposed amendments to 12 C.F.R. § 225.21); *see also* Preamble to Proposed Regulation on Bank Holding Companies and Changes in Bank Control (Regulation Y), at 47,245-48 (summarizing the proposed revisions in subpart C).

7. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,270-71 (stating the proposed amendments to 12 C.F.R. § 225.23); *see also* Preamble to Proposed Regulation on Bank Holding Companies and Changes in Bank Control (Regulation Y), at 47,245-48 (summarizing the proposed revisions in subpart C). 12 C.F.R. 225.23 (proposed).

determined to be permissible by the Federal Reserve by regulation or order, subject to the restrictions or conditions contained in the statute, regulation or order, so long as the book value of assets to be acquired does not exceed 10% of total risk weighted assets and the gross consideration does not exceed 15% of consolidated tier one capital.[8]

For bank holding companies desiring to commence new activities de novo, no prior notice or approval is required; rather, written notice is provided to the Federal Reserve no later than 10 days after commencing the activity. For such companies desiring to commence in an activity through acquisition, the company must provide 12 business days prior notice to the Board, indicating the description of the activity and the terms and conditions of the transaction.

In order to implement the new legislation, the Board must adopt certain regulatory modifications, including a definition of a "well capitalized" bank holding company.

There is a general updating of the list of permissible activities. Certain activities that had routinely been approved by order were added to the list (riskless principal transactions, private placement services, foreign exchange trading for the bank holding company's own account, dealing in precious metals, employee benefits and career counseling consulting, asset management and collection, acquiring and resolving debt in default, and real estate settlement services). A number of restrictions applicable to derivatives and foreign exchange activities that are not applicable to non-bank holding company subsidiaries but which are overseen by the SEC or NASD are eliminated.[9]

The ability to add new activities to the list is expanded. The Board could do so on its own initiative. Further, bank holding companies could get clarification from the Board that variations on particular activities are permissible without having to go through the notice approval process under a new procedure for advisory opinions.[10]

The Board would build in additional flexibility in the non-banking area by allowing companies in the data processing and management consulting areas to conduct greater incidental activities. In

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8. H. R. CONF. REP. NO. 863, 104th Cong., 2d Sess. 416, reprinted in 1996 U.S.C.S. 4738.

9. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,273-76 (stating the proposed amendments to 12 C.F.R. § 225.28).

10. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,273 (stating the proposed amendments to 12 C.F.R. § 225.27).

general, in either area the bank holding company could derive up to 30% of its revenues from otherwise impermissible activities. In data processing, 30% of revenues could come from providing non-financial data processing, and in consulting, 30% of revenues could come from consulting services to entities other than financial institutions.[11]

Generally, time limits on approvals for non-banking activities would be eliminated. Previously, an activity had to be commenced within one year. This change would allow well capitalized bank holding companies to get blanket, broad approvals, potentially of all listed activities, without the need to re-apply. So long as the company maintained its capital position and a favorable regulatory posture, no additional or further application would be required.[12]

Certain restrictions on advisory activities would be removed, including the prohibition on owning shares of an advised mutual fund, a prohibition on a bank lending to an advised mutual fund, a prohibition on loaning against advised mutual fund shares, and the name restriction. Names could be similar so long as they are not identical, do not use the term "bank," and appropriate disclosures are made.[13]

The Board proposed to allow, without the need for application or approval, bank holding companies to acquire lending assets from third parties. There would be no geographic or product restrictions (currently limited to consumer and mortgage assets), and the dollar limits would be raised to the lesser of $100 million or 50% of the existing lending assets of the holding company.[14]

The Board went through and eliminated a number of restrictions on non-banking activities within the approved list.

New activities have been allowed in the "extending credit" area (credit bureau, collection agency, appraisal, asset management, check guarantee, real estate settlement)[15], and leasing (the remaining re-

11. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,275-76 (stating the proposed amendments to 12 C.F.R. § 225.28(b)(9),(14)).

12. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,272 (stating the proposed amendments to 12 C.F.R. § 225.25); *see also* Preamble to Proposed Regulation on Bank Holding Companies and Changes in Bank Control (Regulation Y), at 47,245-48 (summarizing the proposed revisions in subpart C).

13. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,281 (stating the proposed amendments to 12 C.F.R. § 225.125(f),(g)).

14. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,270 (stating the proposed amendments to 12 C.F.R. § 225.22(c)(8)).

15. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,273 (stating the proposed amendments to 12 C.F.R. § 225.28(b)(2)).

strictions are that the lease be non-operating and be at least for a 90 day term).[16]

The investment advisory area has been considerably broadened, specifically listing as permissible advising an investment company, sponsoring, organizing and managing a closed-end investment company, furnishing economic information and forecasts, advising on mergers and corporate transactions, and providing advice on derivatives transactions. Restrictions were also deleted in the areas of tax planning and of consultation and consumer counseling services, particularly relating to promoting specific products and services and obtaining or disclosing confidential information.[17]

The securities area was extensively clarified. In the private placement area, a number of restrictions were lifted, including extending credit to enhance marketability, providing advice to purchasers and placing securities with non-accredited investors[18]. For futures commission merchant activities, non-financial futures would be permissible, as would clearing of derivative contracts under circumstances where the futures commission merchant does not provide execution of the contract.[19] The Board announced that it would consider lifting its prohibition on bank holding companies becoming exchange members, thus potentially changing its policy that futures commission merchant activities be conducted through a subsidiary.

The proposal would allow bank holding companies to invest as principal in derivatives on financial and non-financial commodities, so long as the underlying asset is a permissible investment, the contract provides for cash settlement or the contract provides a mechanism to avoid physical delivery and the bank holding company makes every effort to avoid delivery. Bank holding companies may buy, sell or store precious metals, trade in foreign exchange and bank-eligible securities.[20]

In the consulting area, the list of activities includes financial, economic, accounting or auditing services, which may be provided to any company, not just to financial institutions and their affiliates.

16. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,273-74 (stating the proposed amendments to 12 C.F.R. § 225.28(b)(3)).

17. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,274 (stating the proposed amendments to 12 C.F.R. § 225.28(b)(6)).

18. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,274 (stating the proposed amendments to 12 C.F.R. § 225.28(b)(7)(iii)).

19. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,274 (stating the proposed amendments to 12 C.F.R. § 225.28(b)(7)(iv)).

20. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,274-75 (stating the proposed amendments to 12 C.F.R. § 225.28(b)(8)).

Second, as previously noted, up to 30% of revenues may be derived from any type of management consulting services to any customer or any matter.[21]

Bank holding companies and subsidiaries would be authorized to issue and sell money orders and similar consumer payment instruments without regard to the face amount of the instrument.[22]

The Board proposes to revise the data processing area similar to that proposed for consulting. A bank holding company may provide data processing and data transmission services to anyone, so long as the data is financial, banking or economic. The bank holding company may provide advice to anyone regarding the processing or transmitting of such data. Hardware provided in connection with data processing or transmission activities can be provided so long as it does not constitute more than 30% of a packaged offering, up from the current 10%. Finally, up to 30% of revenues may be derived from processing or transmitting non-financial, banking or economic data.[23]

III. RELAXATION OF TYING RULES

The Board proposed a series of changes to its rules regarding tying arrangements.[24] Many were designed to eliminate restrictions that the Board had added over time that were beyond those required by the applicable statute, Section 106 of the Bank Holding Company Act.

The Board proposes to eliminate its regulatory extension of Section 106 to non-bank affiliates of banks. The statute restricts a bank from restricting the availability or varying the consideration for one of its products or services on the condition that the customer obtain or purchase another product or service offered by the bank or any of its affiliates. The Board's regulation had previously treated non-bank affiliates as banks, thus prohibiting a non-bank affiliate from restricting or varying the price on one of its products and services. Because the Board views the market for financial services as being extremely competitive, it sees no reason to extend the statute farther

21. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,275 (stating the proposed amendments to 12 C.F.R. § 225.28(b)(9)).

22. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,276 (stating the proposed amendments to 12 C.F.R. § 225.28(b)(13)).

23. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,276 (stating the proposed amendments to 12 C.F.R. § 225.28(b)(14)).

24. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,263-64 (stating the proposed amendments to 12 C.F.R. § 225.7).

than is required.

Section 106 allows a bank to tie a product or service to a loan, deposit, discount or trust service offered by that bank. The Board had previously granted a "regulatory traditional bank products" exception, allowing banks to provide discounts on a traditional bank product conditioned upon obtaining another bank product from an affiliated bank. The proposal extends that exemption, by allowing a bank to extend a product or vary the consideration thereof on the condition that the customer either obtain a traditional bank product from an affiliate or provide some additional credit, property or service to an affiliate that is related to and usually provided in connection with a traditional bank product. This proposal, while but a modest extension, does allow a bank to withhold a product based upon dealing with an affiliate, not just vary the consideration, and allows the tied product to be related to a traditional bank product.

IV. OTHER REGULATORY CHANGES

The procedures for establishing bank holding companies were further liberalized. The Riegle-Neal Interstate Banking Act established a streamlined, 30-day notice procedure for existing shareholders of a bank to form a bank holding company. Under the current rules, the existing shareholders must acquire 80% of the shares of the holding company, there must be no supervisory concerns, and all shareholders must be identified. The proposed rule would relax the percentage ownership requirement to 67%, and only shareholders owning 10% or more of the shares would be required to certify that they are subject to no administrative or supervisory action. Publication requirements would be eliminated. The Board would continue to consider the competitive, financial and competitive factors, as well as convenience and needs and CRA issues.[25]

Procedures under the Change in Bank Control Act are also proposed to be modified. One significant change is the elimination of the two threshold test the Board had inserted into the process. Previously, notices were required whenever a party passed both the 10% and the 25% levels. Now, a single notice will be filed, and absent instructions from the Board, no further filing will be required as ownership levels increase over time. Other changes include creating certain regulatory presumptions for such things as "acting in concert;" permitting legal notices to be published up to 30 days prior to

25. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,268 (stating the proposed amendments to 12 C.F.R. § 225.17).

submission of the actual Control Act notice; and eliminating some of the burdens associated with inadvertent acquisitions of control caused by such things as stock redemptions by the issuer.[26]

The Board has proposed changes to the procedures associated with the so-called Section 914 notices, which require notice to the regulators when changes are made to executive officers and directors under certain circumstances. The revisions would incorporate exceptions to the filing requirements for charter conversions and phantom bank mergers if the predecessor institution has been in existence for two years. It would also incorporate the now-standard practice of allowing individuals seeking board of director positions without the support of management to submit 914 filings after the election, under the condition that if the notice is disapproved, the person would resign. There are minor changes to the appeals procedure associated with denied notices and certain other changes designed to bring the banking agencies into greater conformity.[27]

V. COMMENTS

The revisions are extremely helpful in many respects. For those organizations that meet the well capitalized/well managed criteria, the regulatory burdens associated with applications and notices under Sections 3 and 4 of the Bank Holding Company Act should be substantially lessened. One important factor, however, will be the manner in which the Board addresses the issues associated with protests that have often delayed transactions and approvals, even for those institutions with outstanding CRA and compliance ratings.

The Board estimates that 85% of bank holding companies with over $100 million of assets will qualify for the expedited processing procedures, and that over 50% of all applications and notices submitted during 1995 would have so qualified.

On the other hand, there is still some rigidity built into the framework. There are no remarkable new powers or activities added to the list. Virtually all of the additions are simply reflections of the Board's recent orders or of its current practices. The 30% revenue leeway added in the consulting and data processing areas are particularly helpful, but greater flexibility to engage in incidental, impermissible activities in other areas would be a significant benefit.

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26. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,276-77 (stating the proposed amendments to 12 C.F.R. § 225.41).

27. *See* Banking Holding Companies and Changes in Bank Control (Regulation Y), 61 Fed. Reg. at 47,280 (stating the proposed amendments to 12 C.F.R. § 225.72).

It is simply too difficult in many of these non-banking areas to compete with unregulated entities without the ability to adjust to the realities of the marketplace, which may or may not conform precisely to the Federal Reserve's criteria.

One modest disappointment is that the Board continues to assert jurisdiction over activities of subsidiaries of banks.[28] Notwithstanding the *Citicorp* decision of the Second Circuit,[29] the Board would continue to require applications from state chartered banks only if they are engaged solely in activities in which the parent bank may engage, at locations at which the bank may engage in the activity, and subject to the same limitations as if the bank were engaged in the activity directly. The freedom to use bank subsidiaries to conduct financially-related activities, even if not explicitly permissible in the bank itself, is an important component of strategic and marketplace flexibility. Because these activities continue to be subject to the oversight of state and federal regulators, there seems to be little sense, in a regulatory initiative designed to reduce burdens, to continue to extend the Board's reach to bank subsidiaries.

28. 12 C.F.R. § 22(d).

29. Citicorp v. Board of Governors, 935 F.2d 66 (2d Cir. 1991), *cert. denied sub nom.* Independent Insurance Agents of America v. Citicorp, 502 U.S. 1031 (1992).